JERROLD OPPENHEIM, ESQ.

57 MIDDLE STREET GLOUCESTER, MASSACHUSETTS 01930-5736 USA +1 (978) 283-0897•Fax +1 (978) 283-0957

<u>JerroldOpp@DemocracyAndRegulation.com</u> www.DemocracyAndRegulation.com

September 10, 2007

Mary Cottrell, Secretary Department of Public Utilities One South Station Boston, Mass. 02110

RE: Docket 07-50, Rate Structures to Promote Efficient Deployment of Demand Resources

Dear Secretary Cottrell,

Enclosed is the original and 17 copies of the Comment of Low-Income Weatherization And Fuel Assistance Program Network And Massachusetts Energy Directors Association in this docket.

Pursuant to the Hearing Officer's notice dated August 9, 2007, this is my notice of my wish to participate in the hearings scheduled for the weeks of October 22 and October 29, 2007. The requested information is as follows: (1) Complete contact information appears at the top of this letter; I represent the Low-Income Weatherization And Fuel Assistance Program Network And Massachusetts Energy Directors Association; (2) My qualifications to testify are that I have represented consumer and low-income interests in utility matters in several jurisdictions for more than 35 years, have written a book on the subject (Democracy And Regulation), and am conversant with ratemaking theory and practices across time and across the country; (3) The subject matter on which I wish to comment is the impact of decoupling proposals on low-income and other consumers; (4) My opinion may be summarized as that the Department should take no action in this docket because the existing incentive system has created some of the most successful efficiency programs in the country. The straw proposal would be unlikely to improve incentives to invest in efficiency because (a) unlike the existing system, it would not bear a specific relationship to efficiency efforts, (b) it would create new economic risks and shift risks that are more easily borne by utilities, including rate volatility, to families, (c) it would create a single issue rate mechanism, and (d) it could have substantial adverse impacts on low-income consumers. The bases for these opinions are set out in the enclosed Comment.

Please let me know if any further information is desired or there are any questions concerning this request or the enclosed Comment.

Sincerely,

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF PUBLIC UTILITIES

Investigation by the Department on its)	
own Motion into Rate Structures that)	
will Promote Efficient Deployment of)	D.P.U. 07-50
Demand Resources)	

COMMENT OF LOW-INCOME WEATHERIZATION AND FUEL ASSISTANCE PROGRAM NETWORK AND MASSACHUSETTS ENERGY DIRECTORS ASSOCIATION

This is the Comment of the low-income weatherization and fuel assistance program network ("the network") and the Massachusetts Energy Directors Association ("MEDA"). The network consists of the agencies that deliver low-income energy programs in the Commonwealth, including the federal weatherization program, the utility-funded efficiency programs overseen by this Department, foundation-funded efficiency programs, renewables programs funded and overseen by the Massachusetts Renewable Energy Trust, and the federal fuel assistance program. MEDA is an organization of the energy directors of those agencies.

SUMMARY: We recommend that the Department take no action in this docket because the existing incentive system has created some of the most successful efficiency programs in the country. The straw proposal would be unlikely to improve incentives to invest in efficiency because (a) unlike the existing system, it would not bear a specific relationship to efficiency efforts, (b) it would create new economic risks and shift risks that are more easily borne by utilities, including rate volatility, to families, (c) it would create a single issue rate mechanism, and (d) it could have substantial adverse impacts on low-income consumers.

I. INTRODUCTION: THE EXISTING INCENTIVE SYSTEM

We appreciate this opportunity to share our viewpoint as advocates for low-income customers. We are especially pleased that the Department has established a focus on the efficient deployment of demand resources in the Commonwealth, including the efficiency measures and distributed resources installed by the network.

Massachusetts utility efficiency programs have received countless national awards and are unsurpassed across the country in terms of quality, comprehensiveness, and efficiency of delivery. It is instructive to review the system of incentives that has led to this result.

Under agreements approved by this Department since the advent of electric utility restructuring, which mandated specified spending on energy efficiency programs, Massachusetts electric utilities receive performance-based incentives. Each year, design criteria are agreed upon by the utilities and stakeholders, and approved by the Division of Energy Resources and the Department. These criteria generally include kWh and kW reduction goals as well as programmatic criteria. When design criteria are met, utilities receive an incentive that currently amounts to five percent of budget; this incentive is adjusted for exemplary or lower-than-design performance. All kW and kWh reduction is subject to strict performance evaluation.

Massachusetts gas utilities operate their efficiency programs subject to performance-based lost-based revenue (LBR) recovery guidelines established by this Department. Under LBR, the margins that would have been earned from evaluated therm savings are restored to each utility.

In addition to incentives or LBR, utilities receive other benefits from their energy efficiency programs. Each program is established under the individual names of the utilities – however they are actually delivered – in order to retain and enhance the relationship between customer and utility. Efficiency programs are understandably popular, since they lower customer bills, and this positive impact is identified with the utility.

The lowering of customer bills results in other benefits for utilities. Lower bills are easier to pay, which results in lower arrears, reduced bad debt, fewer shut-offs for non-payment, and increased customer retention due to the decrease in shut-offs.⁴

What is most notable for this docket about the Massachusetts utility-funded efficiency programs is that they have been established, expanded, very successfully implemented, and won awards – all within the existing structure of incentives or LBR. MEDA and the network are very supportive of the efforts to capture all economic (societally cost-effective) efficiency. However, the 20+-year history of utility-funded energy efficiency in Massachusetts shows that the current balance of incentives is well-tuned to deliver the scale of efficiency investment the Commonwealth requires.

Data from California demonstrate the basic truth that the single element of a financial incentive is in no demonstrable way related to the level of efficiency investment:⁵

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¹ Boston Gas also operates its efficiency programs under an incentive agreement.

² Low-income interests are represented by the Low-Income Energy Affordability Network (LEAN).

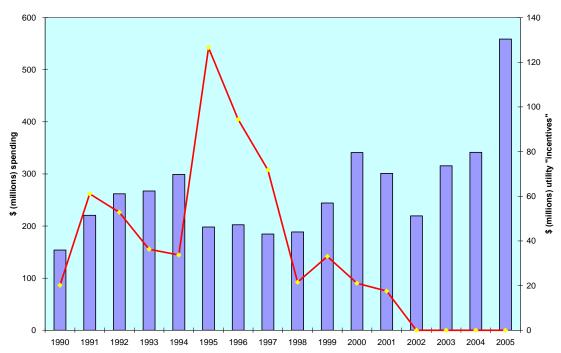
³ An example of programmatic criteria is the Best Practices collaboration under the low-income programs. Under this series of annual agreements, utilities support contractor and auditor training, review best practices in measure installation, and consider possible new efficiency measures.

⁴ Some of these benefits are measured and captured in non-energy benefits (NEBs) that are part of the cost-effectiveness analysis of low-income programs.

⁵ Prepared by Marcel Hawiger, The Utilty Reform Network (TURN), San Francisco. PG&E, SCE, and SDG&E are the California IOU electric utilities: Pacific Gas & Electric Co., Southern California Edison, and San Diego Gas & Electric Co.







If anything, the California experience suggests efficiency investment is *inversely* proportional to the incentive. In any event, as the incentive was reduced to zero in 2002, efficiency investments climbed to record levels.

Similarly, Iowa's per capita efficiency spending leads the nation (Massachusetts is third) with no incentives at all. Indeed, the vast majority of states with efficiency programs have no decoupling provision – and one state has adopted decoupling but has no efficiency program.

The straw proposal in this docket is a revenue-per-customer cap that would hold utilities harmless from any change in revenue per customer, from whatever cause. It seems particularly unlikely to serve as an incentive to additional efficiency investment since the terms of the proposal bear no relationship to efficiency. The proposal would decouple revenues from sales so sales reductions due to efficiency would have no bearing on utility revenues. However, sales reductions from all other sources – from abnormal weather to a weakened economy – would also have no bearing on utility revenues. Under the current Massachusetts system, performance is required for recovery. Under the straw proposal, recovery would occur whether or not there is any performance.

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⁶ John Perkins, Iowa Consumer Advocate, "Policy Options for Energy Efficiency Programs: Decoupling, Incentives & Third-Party Administrators" (NARUC Summer Meeting presentation, July 17, 2007).

⁷ *E.g.*, NARUC, "Decoupling for Electric and Gas Utilities, Frequently Asked Questions" (Review Draft, July 12, 2007); K. Costello, "Revenue Decoupling for Gas Utilities" (NRRI 06-06, April 2006).

In sum, the existing Massachusetts system of incentives and cost recovery has been very successful and need not be disturbed. A move from the existing system to the straw proposal would diminish incentives for efficiency performance.

II. DIFFICULTIES WITH DECOUPLING

Not only is there no reason to change the existing system, but there are also important concerns that militate against the straw proposal.

A. FOCUS ON UTILITY EFFICIENCY INVESTMENTS

We heartily agree on the goal of capturing all economic (societally cost-effective) efficiency. Indeed, investment in all societally cost-effective energy efficiency should be as much a part of utility service as maintaining voltage and pressure. We agree that a proceeding is needed to determine how that is to be accomplished in a way that balances the interests of consumers, society, and utilities. But we do not understand the benefit of a mechanism unrelated to efficiency.

The present Massachusetts electric efficiency system should be the starting point for any analysis of this issue: mandate achievement of specific efficiency targets and provide utilities with incentives that are analogous to service quality standards. Any movement to recovery irrespective of efficiency performance would be a step backwards from current performance requirements. Perversely, the straw proposal would provide utilities with recovery for efficiency improvements it did not bring about, such as that produced by high prices, appliance efficiency standards, or efficiency building codes.

B. UTILITIES ARE BEST ABLE TO BEAR RISK

One of the fundamental tasks of utility rate regulation is to allocate economic risks. One useful guideline is that risks be assigned to the sector best able to bear it. In the case of revenue decreases caused by general economic conditions, Massachusetts-specific economic conditions, or the weather, utilities are far better able to bear risk than most families. And this is one of the principal reasons utility returns on equity are set above Treasury rates: revenues are at risk and variable; they are not guaranteed. Relatively high equity ratios are also a tool to absorb economic risk. If the risk of revenue variability is eliminated, it is difficult to see much need for any equity; something close to the all-bond financing that municipal utilities employ would become financially prudent.

The straw proposal would not only shift risk to families; it would create a new economic risk for society at large. In an economic recession (when utility sales normally decrease), fiscal and monetary policies generally call for stimulus that adds funds to the economy – such as federal budget deficits, lower taxes, and easier money. Yet the straw proposal would have exactly the opposite, contractionary result: when recession causes utility sales

⁸ See, e.g., J. C. Bonbright, <u>Principles of Public Utility Rates</u> (Columbia Univ. Press. 161) at 154.

to decline, the straw proposal would *raise* rates, drawing funds out of the economy and potentially extending the contraction.

Similarly, when high commodity costs cause natural conservation, rates would increase both because of the increased commodity cost but also because of the lower sales.

Thus rates would also become more volatile as a result of the added factor of decoupling, adding further to consumer risk.⁹

C. AVOID SINGLE ISSUE RATE MECHANISMS

In general, single-issue rate cases and single-issue rate mechanisms are distrusted because they ignore other costs and revenues that may be going in an opposite direction. ¹⁰ A recent National Association of Statue Utility Consumer Advocates (NASUCA) proposal states the point succinctly. NASUCA recently adopted a resolution in which it vowed "To continue its long tradition of support for the adoption of effective energy efficiency programs" but in which it also determined "to oppose decoupling mechanisms that would guarantee utilities the recovery of a predetermined level of revenue without regard to the number of energy units sold and the cause of lost revenue between rate cases." In addition, "NASUCA urges Public Utilities Commissions to disallow revenue true-ups between rate cases that violate the matching principle, the prohibition against retroactive ratemaking, the prohibition against single-issue ratemaking, or that diminish the incentives to control costs that would otherwise apply between rate cases." Finally, where efficiency-related decoupling is adopted, "NASUCA recommends that the mechanism be structured to (1) prevent over-earning and provide a significant downward adjustment to the utilities' ROE in recognition of the significant reduction in risk associated with the use of a decoupling mechanism, (2) ensure the utility engages in incremental conservation efforts, such as including conservation targets and reduced or withheld recovery should the utility fail to meet those targets, and (3) require utilities to demonstrate that the reduced usage reflected in monthly revenue decoupling adjustments are specifically linked to the utility's promotion of energy efficiency programs."¹¹

In the case of the straw proposal, while revenues may be decreasing, costs may also be decreasing – particularly likely in a recessionary period when the cost of money tends to decline. Thus utilities might reap a windfall at consumers' expense by not only making up for lost revenues but also by continuing to collect expenses that no longer exist.

⁹ *E.g.*, "Maine PUC Report on Utility Incentive Mechanisms for the Promotion of Energy Efficiency and System Reliability", February 1, 2004, pp. 28-29; Maurice Brubaker, "Distribution Pricing: Do Revenue Caps Set Appropriate Distribution Pricing: Do Revenue Caps Set Appropriate Incentives? Are they Fair to Consumers and Incentives? Are they Fair to Consumers and Investors? (Harvard Electricity Policy Group, San Diego, March 2005).

¹⁰ E.g., Bay State Gas Co. D.T.E. 05-27, at 45 et seq. (Nov. 30, 2005). As recently as less than two years ago, the commission rejected an adjustment mechanism for investments basic to utility service that a utility would and should make in the absence of the clause. *Id.* at 49. There are rare cases where particular events have been judged to outweigh these considerations, e.g., large general tax changes, fuel cost increases at the scale of the 1970s oil price shocks.

¹¹ NASUCA Resolution 2007-01 (June 2007).

Related to this consideration is the need for full-blown rate cases for every utility in the Commonwealth if decoupling is adopted since "cast-off" rates will need to be set. ¹² This would be a substantial burden on utilities, intervenors, the Attorney General, and the Department, the size and scope of which would far outweigh the minimal benefits to be achieved from the straw proposal. Indeed, because of the lack of detailed rate review under the straw proposal mechanism, any decoupling mechanism should be coupled with an increased oversight of expenses through periodic rate cases after the cast-off case, thus causing permanently increased burdens on the regulatory system. ¹³

D. PROTECT LOW-INCOME CONSUMERS

Of particular concern to us is the substantial adverse impact decoupling could have on low-income households. Those who participate in an energy efficiency program will, of course, see reduced bills. However, the programs reach a very small fraction of low-income households each year – and, under current programs, very few low-income tenants. Thus, when sales decline, the vast majority of low-income households will experience rate increases *and* bill increases. Low-income households already use about 15% less electricity than non-low-income households, so they cannot readily compensate for bill increases by reducing energy consumption. Studies show they compensate instead by reducing food intake or medical care.¹⁴

Joyce M. Mercier et al., "Iowa's Cold Winters: LIHEAP Recipient Perspective" (Iowa Department of Human Rights, Division of Community Action Agencies, Bureau of Energy Assistance, June 2000) ("More than one of every five respondents to the "Iowa LIHEAP Energy Survey" (20.9%) reported going without medical care to pay for heating bills." (at file p. 23))

¹² Order at 13.

¹³ Some intervenors who should in fairness be heard, such as low-income advocates, would require intervenor funding to adequately participate in what would become a constant stream of rate cases.

¹⁴ University of Massachusetts Donahue Institute, "Description of LASER Clients, October 2005-August 2007" (for LASER case management program funded by US HHS and operated by the network) (43% of clients skipped rent, food, or medicine to pay a utility bill);

J. Bhattacharya et al., "Heat Or Eat? Cold Weather Shocks And Nutrition In Poor American Families" (National Bureau of Economic Research, Working Paper 9004, June 2002),

http://www.nber.org/papers/w9004, ("Expenditures on food in the home decreased in cold months for poor families but not for richer families.... This decrease in food expenditures by the poor are [sic] not offset by increased expenditures on food outside the home or on clothing" (p. 11). "Among poor families,...a monthly temperature that was 10°F colder than normal would result in a reduction in expenditures on food in the home by \$11/month and an increase in fuel expenditures by \$37/month. Adults and children alike reduce their caloric intake by 10 percent during the winter months, whereas rich family members do not reduce their caloric intake during the winter" (p. 19). "Poor children outside the South consume 292 fewer calories in the winter relative to the summer, poor adults without children consume 299 fewer calories, while poor adults with children consume 374 fewer calories" (page 17-18). "Our results suggest that poor American families with children face stark choices in cold weather. In particular, they increase home fuel expenditures at the cost of expenditures on food and nutritional well-being" (p. 20);

III. RESPONSES TO THE DEPARTMENT'S SPECIFIC QUESTIONS

1. Determine allowed revenues without a rate case?

In our view, abandoning rate cases for the determination of rates would be an abandonment of the Department's responsibility to set rates that are in the public interest. Unexpected and unintended consequences of setting permanent revenue per customer levels are largely unknown and, for the reasons described above, could be adverse to ratepayers generally and low-income families in particular.

2. Determine allowed revenues for a class on the basis of changes in average use per customer?

As noted above, we do not recommend changing rates between rate cases. A focus on revenues, without an accompanying focus on expenses, is unlikely to produce rates that are in the public interest.

3. Annual or more frequent reconciliation?

As noted above, we do not recommend changing rates at all between rate cases, with the exception of mechanisms already in place (for example, fuel clauses and clauses to pass through efficiency incentives or LBR). The general principle we would apply to this question is rate stability, which makes the question an empirical one. Currently, commodity price changes have been far more volatile than those of the aforementioned adjustment clauses as currently constituted.

4. Base revenue on billed or cash revenue?

Revenues for rate purposes are now based on billed revenues less a bad debt reserve. Considerable study and debate should precede any change from this long-standing accounting practice.

We are concerned, for example, that, once the bad debt reserve is set, there is an incentive to reduce actual bad debt (since the utility keeps the difference between rate cases) by increasing the harshness of collection practices. Thus, basing revenues on cash received may lessen the pressure on collection practices. This is a particular concern with respect to low-income customers who have few options.

On the other hand, a cash basis could effectively remove utilities' incentive to reduce bad debt through such creative measures as arrearage management, although the risk of such a strategy would be minimal. Indeed, a cash basis, especially when applied to non-low-income arrears, may tend to increase bad debt and thus rates over the long term.

Careful consideration is needed to balance these competing concerns.

5. Normalize consumption for weather and other factors?

As noted above, we do not recommend changing rates between rate cases. Furthermore, as noted in the text, we do not think it is in the public interest to transfer such economic risk to customers, who are less able to bear the risk than are utilities that are compensated

through rate-of-return regulation. Normalizing revenues for such factors as weather, economic conditions, appliance standards, building codes, and other factors protects utility revenues from efficiencies utilities do not bring about without providing any incentive to utilities to invest in efficiency measures.

- 6. Adjust energy rates or both demand and energy rates? As noted above, we do not recommend changing rates between rate cases.
- 7. Allow rate changes during reconciliation period? When review mechanism? As noted above, we do not recommend changing rates between rate cases.
- 8. How measure performance of mechanism?

As noted above, we do not recommend changing rates between rate cases. If the Department is concerned about energy efficiency performance, we recommend the Department establish standards for that performance. The current electric incentive system, described above, is a good model.

9. Relationship between mechanism and ROE, capital structure? As noted above, we do not recommend changing rates between rate cases because, among other reasons, it would reduce utility risk by increasing customer risk. Removing major business risks would substantially undermine the rationale for a return much above risk-free rates or, indeed, for maintaining very much equity in capital structures.

10. Earnings sharing provision?

As noted above, we do not recommend changing rates between rate cases.

11. Should mechanism include PBR?

As noted above, we do not recommend changing rates between rate cases.

12. How schedule implementation, including rate cases?

As noted above, we do not recommend changing rates between rate cases.

13. How should mechanism affect current efficiency incentives?

As noted above, we do not recommend changing rates between rate cases. We think the existing incentive system is a superior way of encouraging efficiency investment and that it should be retained. We think that the existing LBR, which is a decoupling mechanism tied to efficiency performance, is superior to the straw proposal.

IV. CONCLUSION.

Wherefore, for all these reasons, the low-income weatherization and fuel assistance program network and the Massachusetts Energy Directors Association respectfully recommend to the Department that it close this docket and take no action on the proposed decoupling mechanism.

Respectfully submitted,

The low-income weatherization and fuel assistance program network, and Massachusetts Energy Directors Association

By their attorney

Jerrold Oppenheim 57 Middle Street Gloucester, Mass. 01930 978-283-0957 JerroldOpp@DemocracyAndRegulation.com

September 10, 2007